UiO : Det juridiske fakultet

A comparative analysis of the petroleum regime in Norway and in the U.S.A., with emphasis on the conduct to expect of the operator under the AAPL-810 Offshore Deep-water JOA and the mandatory operating agreement for participants on the Norwegian continental shelf

Kandidatnummer: 761

Leveringsfrist: 25. april 2013

Antall ord: 14 755

TABLE OF CONTENTS

1 INTRODUCTION

1.1 Presentation of the subject

The intent of this thesis is to compare and elaborate general characteristics of the petroleum regimes in Norway and in the U.S.A. Especially, the duties of care owed by the operator to non-operators under the mandatory Norwegian operating agreement for the 22nd license-round and the 2007 AAPL 810 offshore model-form JOA for the Gulf of Mexico.

1.2 An introduction to the operating agreement

The Joint Operating Agreement, hereinafter the JOA, is the legal framework between oil and gas companies that engage in joint upstream petroleum production. The basis for entitlements to petroleum is an interest carved out of a *concession* described as a *production license*[1] in Norway, or a *lease* in the U.S.A.
Where joint operations are projected as a result of a production license or lease, several matters have to be specified such as development of the contract area, method of recovery, operation of the well, control procedures, payment of expenses, and division of petroleum. The JOA serves this function, and sets forth each party's fractional interest in the contract area which will serve as basis for each party's share of petroleum and related costs.

One of the parties[2] will be named *operator*. The operator's duty of care and liability to the non-operators under the Norwegian operating agreement[3] and the AAPL JOA[4] is the topic

[1] Section 3-3 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities.
[2] It is not a requirement that the operator is a party to the operating agreement
[3] The Ministry of Petroleum and Energy's mandatory operating agreement (2007) for participants on the Norwegian Continental Shelf

of this thesis.

Before I discuss that subject matter, some knowledge of the petroleum regime in each jurisdiction is necessary to comprehend the agreements. For that reason, I will first explain and compare some general legal *characteristics* of the Norwegian- and U.S. based petroleum activities (Part 2), before I compare the *duty of care* (Part 3)

1.3 Limit of topic

I will not raise questions of the validity of various provisions in the operating agreements, nor will I compare the opportunity for courts to change the terms and the applicable remedies for breach.

2 THE PETROLEUM-REGIME IN NORWAY AND IN THE U.S.A.

2.1 The exclusive right to petroleum deposits

Section 1-1 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities (Hereinafter the petroleum act) gives the Norwegian state a proprietary right to subsea petroleum deposits and the exclusive right to resource management[5].
The area subject to the exclusive right is specified in section 1-4 which is telling that the petroleum act governs subsea petroleum activities in areas subject to Norwegian jurisdiction and on the continental shelf according to international law or treaties. The United Nations Convention on the Law of the Seas[6] represents established international law and the

---

[4] American Association of Professional Landsmen's 810 JOA (2007) for offshore operations in the Gulf of Mexico
[5] The proprietary right applies to mineral resource management on the Norwegian territory including the Exclusive Economic Zone - 200 miles/370km from the seaboard of Norway
[6] The United Nations Convention on the Law of the Seas signed December 10th 1982

convention is signed by Norway. Article 55-73 in the convention allows the State to exercise sovereign rights seaward 200 nautical miles/370km from the baseline. Further, article 76(1) and 77 lets the State explore and exploit natural resources in areas where the continental shelf exceeds 200 nautical miles seaward.
The Norwegian State signed treaties with The United Kingdom and Denmark during the 1960s settling areas with sovereign rights, leaving only ocean boundaries to Russia in the Barents Sea unsettled. However, The Norwegian State compromised with Russia and signed a bilateral treaty in 2011, thus settling the last dispute regarding ocean boundaries from the mainland of Norway.

The exclusive sovereign right effectively lets the Norwegian State decide whether to produce the subsea deposits itself or allow companies to produce them. Hence, the state can set whatever terms it deems necessary and dictate requirements for companies aspiring to operate on sovereign ground. One of the privileges of the exclusive right amounts to choose how the State shall reserve its *take*[7] of produced petroleum either by producing it on their own, sharing production as a working-interest or carried interest in a group of oil companies, or allowing a private company produce it all. A combination of these methods are chosen with a regime of regulations allowing the state to decide which companies that shall cooperate, who shall be appointed operator, the length of exploration and production, and several other terms. However, the State must exercise these rights within the limitations of EEA-agreement. Among the limitations is a duty to make sure that the parties to the EEA-agreement compete on equal terms, with no discrimination based on nationality[8]. An additional right that follows from the exclusive sovereign right is the authority to impose taxes, like the petroleum tax

[7] In the oil and gas industry, the government's *take* is the State's right to a share of the petroleum. Either monetary or in kind. The State's Direct Financial Interest (SDFI)portfolio is managed by Petoro.
[8] Lov av 27.11.1992 nr. 109 om gjennomføring i norsk rett av hoveddelen i avtale om Det europeiske økonomiske samarbeidsområde (EØS) m.v. (EØS-loven). artikkel 4: *Enhver forskjellsbehandling på grunnlag av nasjonalitet skal være forbudt innenfor denne avtales virkeområde, med forbehold for de særbestemmelser den selv gir.*

In the U.S.A., entitlement to the underground or subsea petroleum will depend on the ownership of the land.

If the land is *private*[9], the owner has an exclusive right to all petroleum produced from the land.

For non-private *public* land, the situation is different. Petroleum from public land is under the exclusive right of the Federal State, the State or the Indian Tribe if the tract is at an Indian reservation (Tribes are "*domestic, dependent nations"*[10] possessing certain inherent sovereign powers)[11].

Public land is divided in *state onshore lands*, *state aquatic and offshore lands*, *Indian lands*, *federal onshore lands* and *federal offshore lands*[12].

State aquatic and offshore lands stretch out seaward 3 nautical miles/5.6km[13]. *Federal Offshore Lands* represent the remaining seaward area 197 nautical miles/364km[14] out in the seabed[15]. Federal royalties on minerals represented about 33% of revenue for the U.S. Treasury in 2006. In comparison, the petroleum activities contributed roughly 26% of the Norwegian government's total revenues..

2.2 Entitlement to petroleum in Norway compared to entitlement to petroleum on different lands in the U.S.A.

As mentioned, the Norwegian government has an exclusive right to all offshore petroleum deposits within the Exclusive Economic Zone or excess areas on the contiguous continental shelf. The ownership of petroleum in the U.S. requires a bit more explanation. I will in the

---

[9] Applies to onshore tracts

[10] Cherokee Nation v. Georgia, 30 U.S. (5 Pet.) 1, 17 (1831)

[11] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg. 911

[12] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg. 834, 835

[13] Ceded to the states by the Submerged Lands Act of 1953 43 U.S.C. §§1301-1315

[14] NOAA, Office of Coast Survey, http://www.nauticalcharts.noaa.gov/csdl/mbound.htm

[15] The Exclusive Economic Zone

following paragraphs compare ownership to onshore oil and gas on *private* land to ownership of oil and gas from *federal* lands. Ownership of oil and gas on U.S. federal land is subject to the same form of ownership as oil and gas on the N.C.S..

2.2.1 Ownership of petroleum produced from U.S. onshore private lands

The private property owner in the U.S.A. is entitled to petroleum resources *on* the surface of his property, *under* the surface of his property. These are resources that can be severed from the rest of the property in *leases,* and then *leased* to companies (titled *Lessees*) wanting to develop and produce them with royalty as consideration to the property-owner. Additionally, the property-owner is entitled to whatever resources he can *access* from the surface of his property according to the *rule-of-capture* doctrine which applies in most states[16]. The private ownership to onshore underground petroleum as *fee simple/fee-simple-absolutes*[17] has a no equivalent in Norway. The Norwegian Mineral Act[18] article 7 exempts *petroleum,* and the act regarding onshore exploration for and production of petroleum[19] gives the Norwegian State an exclusive right to all petroleum resources[20].

2.2.2 Ownership to petroleum produced from U.S. offshore federal lands

Leases to offshore tracts are treated very differently than onshore private leases. The Out Continental Shelf Lands Act authorizes the federal Bureau of Ocean Energy Management

---

[16] States that have adopted the ownership-in-place doctrine and states that have adopted the exclusive-right-to-take doctrine. Though, limited by the *rule of trespass*
[17] States with the *ownership-in-place* doctrine. Most U.S. states
[18] Lov av 19.juni 2009 nr.101 om erverv og utvinning av mineralressurse (MIneralloven)
[19] Lov av 5.april 1973 nr.21 om undersøkelser etter og utvinning av petroleum i grunnen under norsk landområde
[20] Lov av 5.april 1973 nr.21 om undersøkelser etter og utvinning av petroleum i grunnen under norsk landområde artikkel 1

(Hereinafter the BOEM) to sell off leases to offshore tracts in bid rounds[21]. These are sold as a temporary[22] leasehold interest, not *fee simples/fee-simple-absolutes* or similar instruments. If the highest bidder meets certain criteria, he will be entitled to produce the petroleum as a *lessee* with the federal state being the lessor. This way of allocating offshore tracts has several similarities with the concessionary system in Norway, because the Federal State has the proprietary right to exclusive management of the tracts before and after they are conveyed in leases comparable to the *production licenses*[23] in Norway.

2.3 General about the concessionary regime vs. the lease-based regime

The concessionary regime of Norway awards companies a right to explore and produce petroleum based on *licenses*. The Ministry of Petroleum and Energy is in charge of the administration of these licenses[24].There are chiefly two licenses necessary in upstream operations. The first license is the non-exclusive Exploration license[25] which allows companies to explore for petroleum by means of seismic surveys, etc., in a pre-determined area, but not produce petroleum. The other license is the Production License[26] which awards companies the sole right to explore, drill and produce petroleum from blocks[27] covered by the license.

The production licenses are publicly announced *licensing rounds* where companies submit application for the license. The applications are then considered by the Ministry of Petroleum and Energy. After evaluating the applications, the Ministry of Petroleum and Energy will cooperate with the Norwegian Petroleum Directorate and form groups of companies

[21] The last bid round was held in the Superdome in New Orleans March 20th 2013 where drilling tracts that could give production of up to 890 million barrels of oil and 3.9 trillion cubic feet of gas were sold off. Source: *http://www.nola.com/business/index.ssf/2013/03/oil_leases_up_for_bid_in_centr.html*

[22] *5-10 years or so long thereafter as oil and gas is produced in paying quantities*.

[23] See 2.3.2

[24] Section 1-4 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities

[25] Chapter 2 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities

[26] Chapter 3 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities

[27] Section 3-2 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities.

that are awarded[28] production licenses. They will also appoint the operator[29] in each group.

Leases to private onshore land in the U.S.A are conveyed as any other private property on the free market without mentionable interference from the government. Thus, anybody with money, willing to engage in the onshore oil and gas production can acquire leases without having to be approved by a government agency. Though, drilling requires a permit to drill, which may call for some pre-determinations and environmental impact studies.

Leases to federal offshore tracts are subject to a different legal regime. Offshore-leases are conveyed by the BOEM[30] to oil and gas companies in sealed-bid[31] auctions. Bidders place their bids based on seismic data[32] and estimates of possible yield and costs of the block. The lease grants companies as lessees the exclusive right to explore, develop, and produce oil and gas subject to non-negotiable terms and covenants set forth in, among other acts, the Outer Continental Shelf Lands Act of 1953 (Hereinafter the OCSLA)[33]. The act is administered by the BOEM (pre 2010: *Minerals Management Service*) which administers the leases, and controls offshore operations that affect the Federal States' coastal zones[34].
Under the O.C.S.LA, there are four steps in the development of an offshore oil well on federal offshore lands: (1) development of a five-year leasing plan by the Dept. of Interior and BOEM; (2) offering, sale, and issuance of leases by the BOEM; (3) exploration operations by the lessee; (4) drilling, development, and production operations by the lessee[35]. Each

---

[28] The license is awarded in a council comprised of the ministers and the prime minister.
[29] Section 3-7(1) in the Act of November 29th 1996 No. 72 relating to Petroleum Activities
[30] Bureau of Ocean Energy Management
[31] Federal offshore leases are awarded in sealed-bid rounds. Onshore federal leases in oral bid rounds. Source: Professor (J.D) Owen L. Anderson, *Eugene Kuntz Chair of Law in Oil, Gas and Natural Resources*, the University of Oklahoma College of Law
[32] Hendricks, K., R. Porter, and G. Tan, *Bidding Ring and Winner's Curse: The Case of Federal Offshore Oil and Gas Lease Auctions,* NBER working paper 9836
[33] the Outer Continental Shelf Lands Act of 1953 U.S.C. 43
[34] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg. 868
[35] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg. 868

step has environmental analysis components[36].

Comparing the two petroleum regimes, it is quite apparent that the offshore activities in Norway and the U.S.A. are subject to comparable regulatory regime that is not under the influence of the participant.

For example, both require *environmental impact reports* open for public comment referred to as *Environment Impact Study* in the O.C.S.LA and referred to as *Impact Assessment relating to opening of new areas for petroleum activities* in the Norwegian Regulations chapter 2a.

Both the regimes convey a *sole right* to explore for and produce petroleum[37], but not actually undertake operations without additional permits which are obtained after filing *Plan for Development and Operation of Petroleum Deposits*[38] (Norway) and *Development and Production Plan*[39] (U.S.A.).

Both regimes require upfront cash payment referred to as *Bid for lease* in the O.C.S.LA and referred to as *Handling Fee* (Currently NOK 109 000/approximately $20 000) in the Norwegian Regulations.
A fundamental difference is that the *bid for lease* serves as qualification to obtain the lease in the U.S.A., whereas, the *handling fee* is a small fixed *fee* companies must pay to be considered in the licensing round. In the end, the qualification for being awarded a production license is not based on who pays most, but rather which company the Ministry of Petroleum and Energy finds that presents the best plan for development and operation[40], possess

---

[36] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg 868
[37] The production license (The exploration license is not a *sole-right*) and the lease
[38] Section 4-2 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities.
[39] O.C.S.L.A § 1351 (a)(1)
[40] Section 10(b) in the regulations to act relating to petroleum activities of June 27th 1997

the best skills, experience, financial capacity and similar[41].

The difference in upfront payment can partly be explained by comparing the manner in which the government collects its exclusive *take*.

Under the OCSLA, each participant pays a significant amount of money upfront when bidding for the lease[42] and pays ordinarily 28% net income tax[43] plus 37-41%[44] royalty to the federal government.

In Norway, the awardee pays the handling fee, but nothing for the rights conveyed in the production license. The ordinary 28% net profit income tax is though complemented by a special 50% *petroleum tax*[45] (Uplift and unused uplift is not subject the special tax). In sum, the tax on profits from petroleum production is about 78 percent in Norway (Not counting handling fee, area fee[46], production fee[47], cash bonus[48], possible fees for regulatory supervision[49], indirect costs of carrying Petoro). However, the awardees can deduct costs, such as depreciation, financial costs, operations costs, losses and losses carried forward, and also decommissioning costs once they are incurred.

Comparing the regimes, it is quite obvious that engaging in offshore petroleum activities on the O.C.S. requires more start-up capital, largely because a significant part of the government's *take* is intended to be paid through the bid before any production has commenced. It is a viable contention that the financial burden of engaging in offshore activities in the

---

[41] Section 10(a) in the regulations to act relating to petroleum activities of June 27th 1997

[42] The average winning bid for a lease on the O.C.S. was $3 750 000 in the last lease-autcion.
In the March 2013 auction for offshore leases on the O.C.S. the sum of all winning lease bids reached $1.2 billion. 52 oil and gas companies participated in bidding for 320 blocks.
Norwegian Statoil and Samsung Offshore jointly bid $81.8 million to win the second most expensive single lease on it's top priority lease, known as "Walker Ridge 271". Statoil won 15 leases in the bid round.
Source: http://www.boem.gov/Oil-and-Gas-Energy-Program/Leasing/Regional-Leasing/Gulf-of-Mexico-Region/Gulf-of-Mexico-Top-Ten-Highest-Number-of-Bids-on-a-Single-Block-for-All-Sales.aspx

[43] Varies

[44] 2006 Average royalties from the U.S. O.C.S. (Deepwater leases). Source: U.S. Government Accountability Office (GAO), http://www.gao.gov/new.items/d07676r.pdf

[45] The Petroleum Tax Act of June 13th 1975 no 35 Section 5

[46] section 4-10 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities.

[47] section 4-10 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities.

[48] section 4-10 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities.

[49] section 10-3 in the regulations to act relating to petroleum activities of June 27th 1997

U.S.A. is higher[50] than in Norway where the upfront payments are lower. The opportunity to deduct costs in the startup period underpins that statement.

There is also a difference when it comes to government taxation and fees. In Norway, several fees and taxes have to be paid by the awardees of production licenses, among them the *production fee, area fee* and a special 50% *petroleum tax* (And even as dividend, the government *take*[51], from Petoro), whereas the U.S. Federal government claims royalty as a private landowner on the O.C.S., plus ordinary profit tax on profits.

Both regulatory regimes require the bidder to be *qualified* and to show *proof of financial ability* to perform operations[52]. The Petroleum Act and O.C.S.LA impose a minimum *work commitment*[53]
Further, both regimes requires the participants to put up with whatever new legislation that might affect the activities at any time.
Both regimes allow a government agency to prescribe value of production for royalty (tax[54]) purposes in the U.S.A, referred to as *norm price*[55] in Norway.

Fact is that fundamental deviations of the two regulatory regimes for offshore activities are rare.

Though, some fundamental differences can be found. One of them is that there is no statutory right[56] in the U.S.A. for a host government owned company like Petoro to share in a

[50] For blocks with high certainty of yield
[51] See footnote 6
[52] O.C.S.LA 43 U.S.C. § 1337(a)(1), section 10 in the regulations to act relating to petroleum activities of June 27th 1997
[53] O.C.S.LA 43 U.S.C. § 1337(b)(2), section 3-8, 3-9 10 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities
[54] In Norway
[55] section 33 in the regulations to act relating to petroleum activities of June 27th 1997
[56] Chapter 11 in the 10 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities

block as a working interest or a carried interest[57].

The duration of the leases is also aberrant. The U.S. offshore-lease has *two* terms. The *primary* term is 5-7 years, and a *second* term for *so long as oil and gas is produced in paying quantities or approved drilling or well reworking operations are being conducted*[58],[59].The Norwegian production license grants exclusive rights for 10 years, but can be prolonged upon application. Comparing the duration of the offshore-lease and production license, it is quite clear the offshore-lease has a more predictive duration within the control of the lessees, than the production license.

For the theses, however, the most fundamental dissimilarity is that there is not a provision in the O.C.S.L.A. or elsewhere in U.S. legislation requiring a group of lessees to enter in a specific non-negotiable JOA[60]. Hence, it is a viable claim the Norwegian State intervenes more *horizontally* in the relationship between awardees of production licenses, whereas the U.S. government takes a more *vertical* approach.

2.3.1 Financial risk of the lease vs. the production license

One might ask whether the bidder for a lease incurs more financial risk than the applicant for a production license because of the way rights are conveyed in each regime.

One factor is the considerable upfront payment for the lease, which at first glance could support a finding that a participant in the lease-auction incurs more risk in case the block is dry.

However, that contention is partly offset as the price of the lease will reflect the risk. I.e., it is more likely that an expensive lease will yield in commercial quantities.

---

[57] It is worth noticing that Petoro frequently claims a smaller share or waives the right to participate

[58] O.C.S.LA 43 U.S.C. § 1337(b)(2)

[59] *Paying quantities* means production of quantities of oil or gas sufficient to yield a daily profit to the lessee over daily operating expenses, even though the drilling costs, or equipping costs, are never recovered, and even though the undertaking as a whole may result in a loss to the lessee. Source**:** *Reese Enterprises, Inc. v. Lawson***,** 220 Kan. 300, 553 P.2d 885 (1976).

[60] Section 3-3 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities

Nevertheless, investors can hardly ever be fully sure of the stratigraphy of a subsea block, thus an upfront bid in the $90[61] million range will require a cool head.
The same appetite for immediate financial risk is not necessary on the N.C.S.. After paying the relative low handling fee, grantees of the production license can drill test wells and study well samples before decide to incur massive costs for permanent installations.
It is therefore a viable claim that bidding for the expensive blocks in the lease auction requires a bit more risk-willingness than what is necessary when applying for the production license.

2.3.2 More specific about the *terms* of the production license and the lease

The terms of leases to *onshore private* lands in the U.S. are decided by the lessor and lessee, and certain implied covenants. Though, terms of regulatory- and conservation laws will apply.

The terms of the production license are decided by the Ministry of Petroleum and Energy[62] which sets forth the rights and duties that the companies owe to the State. The production license will then complement the Petroleum Act and other regulations with specific terms. Comparably, The BOEM decides the terms of the Federal lease within the limitation of U.S. Federal law.

Companies applying for a production license must fulfill certain requirements that are found in section 3-3 of the Petroleum Act to. The fifth paragraph of Section 3-3 states that *the King may stipulate as a condition for granting a production license that the licensees*

[61] The highest bid in the 2013 lease-auction was $ 93 million. Source: http://www.boem.gov/Oil-and-Gas-Energy-Program/Leasing/Regional-Leasing/Gulf-of-Mexico-Region/Gulf-of-Mexico-Top-Ten-Highest-Number-of-Bids-on-a-Single-Block-for-All-Sales.aspx
[62] Section 3-3 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities

shall enter into agreements with specified contents with one another. Consequently, the Ministry of Petroleum and Energy has drafted a *standard agreement* with non-negotiable terms which companies seeking a production license must enter into.

2.4 The mandatory operating agreement for petroleum activities on the Norwegian continental shelf

This *standard agreement* (Hereinafter the Norwegian operating agreement) sets forth rights and duties between companies that are awarded a production license in the same operating unit.
The MPD JOA, along with the *accounting procedures* and *special provisions,* makes up what is called *Agreement for petroleum activities.*

2.4.1 The collaborative nature of the Norwegian petroleum act, the production license and the agreement for petroleum activities

The collaborative nature of the petroleum act, the production license and the agreement for petroleum activities can be regarded as an inter-related network of rules governing petroleum activities and offering the State a vast flexibility to control each operating unit in detail without participating itself. It is the mandatory model-form operating agreement that makes this relationship special compared to what is required in other industries. By requiring the party to enter into the non-negotiable operating agreement, the government effectively sets the terms of the *horizontal* relationship between the parties.
Thus, depriving the parties of their freedom of contract and integrating the operating agreement to the States regulatory scheme.

The integration of the agreement to the regulatory scheme can be seen in section 7 of the special provisions to the *Agreement for petroleum activities.* Section 7 sets forth a requirement for permission and approval from the Ministry of Petroleum and Energy for any

amendments to the agreement.
The reality is, however, that the Ministry of Petroleum and Energy will in most cases *not* allow amendments[63]. The reason for such a strict interpretation of the language of section 7 is the goal of a uniform JOA with undeviating terms[64].
The fact that entering into the Norwegian operating agreement is a *term*[65] for obtaining a production license makes it obvious that the Norwegian operating agreement is not a fully commercial contract, but subject to the discretion of the government[66]. Hence, the agreement can be regarded as a governed by the law of contracts *and* administrative law[67].

No such requirement is found in the U.S. petroleum regime. The legislature has stuck to the traditional vertical regulatory scheme, where the parties obtain the parties must obey statutory requirements, but retains the freedom of contract in their internal affairs such as the JOA.

However, for the sake of comparison: Even though there are no statutory provision requiring participants in the U.S. oil and gas industry to enter into JOAs, nor any statutory provision enabling the government to set the terms of the JOA, there are oil and gas conversation laws that effectively can *force* a person with a leasehold-interest to enter into a JOA. For example, in Oklahoma, a person with a leasehold-interest can be *forced-pooled* into an operating unit by the Oklahoma Corporate Commission. When being forced-pooled, the leasehold interest-owner can select to be a *carried interest*, or a *working interest* along with the other working interests in the unit. If choosing the latter, the owner of the leasehold-interest will be *forced* to enter into a JOA or another similar agreement setting forth the rights and duties of the working interests-owners in the unit. The force-pooled party must

---

[63] *Samarbeidsavtalens ansvarsbegrensningsklausul for operatører på norsk sokkel – en fremstilling*, kandidatnr. 166158, veileder Johs. Faugstad
[64] Hammer, Ulf m.fl., Petroleumsloven, Oslo 2009, pg.135
[65] Section 3-3(4) in the Act of November 29th 1996 No. 72 relating to Petroleum Activities
[66] Knut Kaasen, *Statdeltakelsesavtalen i norsk petroleumsvirksomhet*: *Kontraktsrettslig form, konsesjonsrettslig innhold- eller omvendt?* Tidsskrift for rettsvitenskap 1984 pg.372
[67] The Code of Administrative Procedure of February 10th 1967

accept the terms set forth by the other parties, because denying the terms has no effect, he will still be forced-pooled allotting his share of the tract to operating unit, thus subject to the terms of the underlying agreement. For that reason, the forced pooled lease-owner will ordinarily not have much opportunity to negotiate the terms of the JOA, which is somewhat comparable to the situation of parties to the Norwegian operating agreement.

2.4.2 The background and development of the operating agreement

The Joint Operating Agreement (hereinafter JOA) has been applied in petroleum activities in the U.S. ever since the first AAPL JOA was developed by the American Association of Professional Landmen (Former: American Association of Petroleum Landmen) in 1956 as the AAPL 610 with minor adjustments in 1977, 1982 and 1989. The last AAPL JOA is the 2007 AAPL 810 Model Form JOA for offshore activities. The latter is for the most part similar to the 1989-form with some modifications deemed necessary for offshore activities[68].

The JOA was introduced in Norway with the first licensing rounds in 1965 and 1972[69]. The first agreements were at first fully commercial agreements negotiated on individual terms comparable to those found in the base AAPL JOA[70]. The strong influence of the U.S. AAPL-form is no surprise given that most of the oil and gas companies on the N.C.S. in the early days of wildcatting were U.S. oil and gas supermajors[71]. The concessionary system was effectuated in the third licensing round and the agreements from the first licensing rounds served as templates for the new mandatory agreement, thus giving the AAPL

---

[68] E.g. the AAPL JOA article 12.4.1 requires the number of well slots or subsea tiebacks to be set forth in the development plan presented in the development plan.

[69] Anne-Karin Nesdam, Knut Kaasen, Jan B Jansen og Joachim M Bjerke, *Articles in Petroleum Law*, Marlus 404 pg 13.

[70] Nils Heilemann, *Revisjon av samarbeidsavtalen og regnskapsavtalen*, Marlus 340, pg 23.

[71] The *supermajors* are the world's biggest publicly traded oil and gas companies. Oklahoma-based *Philips Petroleum* (Operator on the platform Ocean Viking) drilled a well capable of producing in paying quantities on December 23.-24. 1969. The well became part of the Ekofisk Complex. New Jersey-based *Esso* (Operator on Ocean Traveler) drilled their first exploratory well on the N.C.S. in 1966.

agreements a profound foundation on the N.C.S..

The mentioned circumstances are partly the reason why I found that a comparison of the Norwegian operating agreement and the AAPL JOA would be meaningful. The lack of Norwegian preliminary work associated with the original[72] Norwegian operating agreement, lack of court interpretations of the Norwegian operaing agreement (mostly due to the arbitration clause[73]), and the international aspect of the JOAs was also influencing the decision. An upside to the AAPL forms is that the agreements have not changed fundamentally over time[74]. Thus, with considerable oil and gas production in the U.S. since 1859, agreements for petroleum production have repeatedly been exposed to close scrutiny by courts and legal scholars. Consequently, the legal materials associated with oil and gas law are vast and can potentially give rise to interesting comparisons.

2.5 Interpretation of the agreements

The governing principles and methods of interpretation will be determined by the clause setting forth the choice of law. Article 29 in the Norwegian operating agreement requires Norwegian Law to govern disputes arising in connection with the agreement. Thus, Norwegian codes, principles and methods of law apply to the agreement.

Article 26.4.1 of the AAPL JOA allows parties to *choose* default law for disputes arising from the agreement. I will in the following paragraph assume that the parties choose to have their agreement governed by law of a U.S. state. Thus, the principles of interpretation in U.S *common-law* tradition will apply.

---

[72] The Norwegian operating agreement was originally called *Statsdeltakelsesavtalen*
[73] Article 29.1 in the Norwegian operating agreement
[74] Information from Professor (J.D) Owen L. Anderson, *Eugene Kuntz Chair of Law in Oil, Gas and Natural Resources*, the University of Oklahoma College of Law

As a starting point, commercial contracts are interpreted by construing the language *objectively* both in Norwegian civil-law- and U.S. common-law tradition. However, the objective meaning will not be governing if there is a preponderance of evidence showing that the parties had a mutual way of interpreting the agreement that deviates from the objective meaning of the language[75].

2.5.1 Contract or administrative decision

The circumstance that the Norwegian operating agreement is *not* negotiated on commercial terms, makes it somewhat distinct from the AAPL JOA. The distinction arises out of the fact that the Norwegian operating agreement is a government imposed *term* for being awarded a production license, complementing the production license, the petroleum act and regulations[76]. Some legal scholars have articulated that the Norwegian operating agreement has some similarities to *administrative decisions*[77] which customarily are interpreted more objectively than fully commercial contracts where circumstances of a subjective character can be determining on the interpretation[78]. Accordingly, a determination of the relationship established in the agreements is required to determine relevant method of interpretation

The lack of *freedom of contract* can lead to the conclusion that the JOA-relationship is not a contractual, but an administrative decision. The rationale behind such an argument is that the parties engage in the contract *involuntarily* as the contract is a non-negotiable condition[79] for being awarded a production license, and because the terms of the agreement are not decided by the parties.

---

[75] Rt. 2002 s.1155
[76] Tine Harstad Eggen,"*No gain-No loss"-prinsippet I petroleumsvirksomhetens samarbeidsavtaler,* Marlus 359, pg 8
[77] Knut Kaasen, *Statdeltakelsesavtalen i norsk petroleumsvirksomhet*: *Kontraktsrettslig form, konsesjonsrettslig innhold- eller omvendt?* Tidsskrift for rettsvitenskap 1984 pg 390.
[78] Knut Kaasen, *Statdeltakelsesavtalen i norsk petroleumsvirksomhet*: *Kontraktsrettslig form, konsesjonsrettslig innhold- eller omvendt?* Tidsskrift for rettsvitenskap 1984 pg 394.
[79] Section 3-3 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities

On the other hand, the parties voluntarily apply for the production license in the licensing round as a result of free enterprise and freedom of contract. In that process, the parties are fully aware of their obligation to accept to enter into the mandatory MPE. For that reason, I have few concerns deeming the relationship as *contractual*. Consequently, applicable methods of interpretation of contracts will apply to the Norwegian operating agreement.

Whether or not the determination would have had a significant influence on the interpretation is less certain, because interpretations of government decisions and commercial agreement have proved to be remarkably correlating[80]. Consequently, one can assume that the dissimilarity of the agreements when it comes to government influence is of less importance for the interpretation of them.

This contention is further backed by the fact that both the AAPL JOA and the Norwegian operating agreement are *model-forms*. Parties to model-forms will occasionally be unaware of the scope of the agreements and the obligations that lie therein[81]. Thus, allowing model-form provisions to be interpreted *subjectively* can negate the whole intention of model-forms, which is to have a *predictable* set of regulations for parties engaging in a type of project.
Furthermore, developing a uniform operating agreement with substantial predictability for awardees of production licenses on the N.C.S. was one of the main objectives of the Norwegian Ministry of Petroleum and Energy when they standardized the Norwegian operating agreement in 2007[82]. This aim of having a *uniform agreement* with persistent terms would not be achieved if parties were allowed subjective interpretations of the JOA.
In sum, there is ample support for interpreting the contracts objectively in harmony with principles of contract interpretation.

---

[80] Kristian Huser, *Avtaletolkning,* 1983, pg 410 and 435
[81] Information from Professor (J.D) Owen L. Anderson, *Eugene Kuntz Chair of Law in Oil, Gas and Natural Resources*, the University of Oklahoma College of Law
[82] *Samarbeidsavtalens ansvarsbegrensningsklausul for operatører på norsk sokkel – en fremstilling*, kandidatnr. 166158, veileder Johs. Faugstad

2.5.2 The purpose of the operating agreement

2.5.2.1 Risk allocation and capital dispersal

Exploring for- and producing oil and gas is considered a highly risky business, which requires a lot of venture capital and can give rise to astronomical claims[83]. Even more so in present time, when the majority of conventional easily accessible high-output onshore reservoirs are developed and most new exploration is done offshore or in artic environments where the initial capital investment and risk is higher. Expensive technology, such as that necessary for horizontal drilling and fracing operations in shale formations hav further necessitated higher initial investments[84] and has led to pooling of skills and technology. Not to mention the increasing exploration activities in emerging countries where the political risk is considerable[85]. Consequently, one of the most important reasons for entering into a joint venture is *investment risk allocation*. When parties to a JOA jointly explore and drill a wildcat, the damage to each party in case the well proves to be a dry hole is reduced significantly compared to the situation where one company alone has all the risk. If oil and gas companies share the cost of exploring and drilling in new areas, each company can *disperse capital* over several projects and reduce the general risk of doing business.

2.5.2.2 Transaction cost

The reduction in transaction costs for participants in U.S. oil and gas business due to the dominance of model-form JOAs is also apparent. With model-forms reflecting industry

---

[83] The 2010 Deep-water Horizon blow-out in the Gulf of Mexico gave rise to claims in excess of USD 41 billion.
[84] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg 181
[85] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg 191

customs and practice with certainty of meaning and apparent fairness, parties negotiating a JOA can spend their time settling aberrant terms.
The argument applies partly in Norway as well. When parties are not allowed to negotiate the terms of their own JOA[86], the related transaction cost will be lower because there are no terms to settle.

2.5.2.3 Financing

An additional advantage of the JOA is that it is easier to obtain financing. The JOA offers noticeable guarantee and predictability for investors and lenders, who can use this well-known agreement as evidence of actual share of the contract area along with other documentation. Examining the JOA allows investors and lenders to predict how the participant will receive production and pay costs, thus better enabling them to make an informed decision of whether or not to invest or fund part of the project.

2.5.2.4 Disadvantages of the JOA

An apparent downside to entering into a JOA is the loss of control with operations for non-operators. However, it is commonly recognized that the mentioned benefits of a JOA counteract some loss of control. It is worth mentioning that participation in the *management committee*[87] (See 2.6 about the *management committee*) under the Norwegian agreement offers non-operators ample control with operations, thus countering the loss-of-control argument.

[86] Article 3-3(4) in the Act of November 29th 1996 No. 72 relating to Petroleum Activities
[87] Article 1.1 in the Norwegian operating agreement.

2.5.3 General about the operator under each agreement

One of the parties will be appointed to function as the operator with authority to carry out operations such as preparing work-programs and development plans, provide staffing and hiring contractors, conduct operations, account for funds, provide information to non-operators, management committee and partner forum (Norwegian operating agreement) and host government. Furthermore, the operator shall represent non-operators in relation to the host government and third-parties, procure insurance and manage health, security and safety regulations.
In short, the operator will function as *manager* of the contract area, carrying out operations and make certain operational decisions[88].

Likewise, the operator is responsible for hiring contractors. That means that the operators shall contract with third parties such as service contractors providing heli-lift, catering, drilling, and even insurance.
The Norwegian operating agreement article 3.2 specifies that operator acts on *behalf* of the non-operators when dealing with contractors. The consequence of the operator acting on *behalf* of the non-operators is a chance for the third-party, the service-provider, to claim performance from the other non-operators in the event the operator does not comply with his obligations. Thus, the service-provider can make a *direct claim* to the non-operators. That represents a fundamental difference from the AAPL JOA. Article 5.1 specifies that the operator is an *independent contractor* when performing services under the agreement, thus *not* acting *on behalf* of the non-operators. If the operator does not comply with his contractual obligation to a third party, the third party cannot claim compensation[89] from the non-operators.

[88] Under the AAPL JOA, the operator is the ventures upper body of decision-making
[89] Under U.S. common-law tradition, remedies for breach of contract is monetary damages, restitution, rescission and reformation. Very seldom specific performance. That represents a difference from Norwegian civil law-tradition where remedies include specific performance.

The operator is compensated on a *no gain-no loss* basis. This way of compensating the operator is fundamental to JOAs. The *no gain-no loss* principle means that the operator's shall be paid on a *cost recovery basis* with an overhead specified in the accounting provision. Thus, the operator shall not profit from his function as operator in the contract area. Costs incurred by the operator on behalf of the non-operators and petroleum produced shall be distributed according to the share of the contract area and not be a source of profit or loss for the operator. The operator's economic interest shall be based on his share of the contract area, not services rendered as operator[90]. The *no gain-no loss* principle is similar in both the Norwegian operating agreement[91], the AAPL JOA and most other JOAs[92].

2.5.4 Specific about the Operator on the Norwegian Continental Shelf

The Norwegian Petroleum Act article 1-69(k) defines the operators as the one who is "*executing on behalf of the licensee the day to day management of the petroleum activities".* The language of the Norwegian operating agreement elaborates the act, stating that "*The operator shall carry out and administer the day to day management of the joint venture activities*"[93], making the operator in charge of the day-to-day operations in the concession area. Typical responsibilities of an operator on the N.C.S. are drilling, preparing cash-calls[94], supplying mandatory data and documentation to the Ministry of Petroleum and Energy, the partner-forum[95] and the management committee[96]. The operator's authority is not unlimited, however. The Norwegian operating agreements most profound limit on the op-

[90] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg 220
[91] Article 3.1(3) in the Norwegian operating agreement
[92] Such as the AIPN JOA
[93] Article 3.1 in the Norwegian operating agreement
[94] Article 12(1) to (5) in the Norwegian operating agreement
[95] Article 5 in the Norwegian operating agreement
[96] See 2.5.4.1

erator's will is the *management committee's* decision-making authority with binding effect upon the operator[97].

2.5.4.1 The management committee

Each company having a share of the concession area (One or more blocks) on the N.C.S. in the form of a production license is eligible to participate in the *management committee* which consists of one member and one deputy member from each company[98].
Participation in the management committee allows non-operators to take an active role in the decision-making process. According to the Norwegian operating agreement article 1.3, the management committee is the venture's upper body of decision-making and decides in most matters of importance. The mandatory management committee might represent the most fundamental difference between Norwegian upstream development and US-based upstream development.

2.5.4.2 More specific about the operator in the U.S.A.

The AAPL JOA has no provision for a management committee. The AAPL JOA article 5.1 states that *"the Operator has the exclusive right and duty to conduct (or cause to be conducted) all activities or operations under this Agreement. In performing services under this Agreement for the Non-Operating Parties, the Operator is an independent contractor, not subject to the control or direction of Non-Operating Parties"*
It is apparent from the language of article 5.1 in the AAPL JOA that the operator is the venture's upper body of decision-making. The operator is given a profound ability to decide and control how the operations should be carried out, not limited by a management committee or similar control sharing mechanisms. Compared to the Norwegian operating

[97] Article 1.3 in Norwegian operating agreement
[98] Section 1-1 in the Act of November 29th 1996 No. 72 relating to Petroleum Activities.

agreement, the AAPL JOA vests a vast freedom of choice upon the operator not found in the Norwegian operating agreement.
However, the AAPL agreement contains some restrictions on the operator's discretion in decision that have a great impact on the venture's activities. There is a requirement for non-operator consent in decisions such as revision of well-plan[99], cease of drilling[100], Long Lead development system AFE[101], withdrawal[102], deepening, plugging and abandoning a well.

In sum, the operator is given ample freedom of choice under the AAPL JOA not found in the Norwegian operating agreement. But the freedom is not unlimited, as the AAPL JOA specifically sets forth
operations that require consent of the non-operators, which for those situations is comparable to the structure in the Norwegian operating agreeement.
It is noticeable that the operator's freedom of choice is *positively defined*[103] in the AAPL JOA, whereas the freedom of choice seems to be *negatively defined*[104] in the Norwegian operating agreement.

The operator's freedom of choice is further restrained because of his duties of care towards the non-operators. I aim to compare that duty in the following section.

[99] AAPL JOA art. 10.1.1
[100] AAPL JOA art. 11.1.4-c
[101] AAPL JOA art. 12.6
[102] AAPL JOA art. 17.2.1
[103] Positivt avgrenset
[104] Negativ avgrenset

3 OPERATOR CONDUCT

3.1 Conduct

In this section I will elaborate rules elaborate duties of care under the Norwegian operating agreement and the AAPL JOA, and compare them as I go. However, the sources of applicable law are not the same[105]. For that reason, there will be several occasions where I don't compare agreement to agreement, statutory law to statutory law, as ordinary methods of law would prescribe.

I aim to examine the conduct in an order starting with the source of law prescribing the *lowest* duty of conduct, before I move towards the source of law prescribing the *highest* applicable duty of conduct.

I will first compare duties of good faith, then duties of cooperation, before I compare the highest applicable duty of care derived from article 5.2.1 in the AAPL JOA and the doctrine of *loyalty in contracts.*

I will focus on the duty of *care* towards the non-operators, such as having regard for their interest. I will *not* examine the general skill, caution, expertise and prudence an operator must show when conduction *production operations*.

The manner in which production operations must be performed is set forth in the petroleum act section 4-1 about *prudent production.* Section 4-1 requires production to take place in accordance with *prudent technical and sound economic principles and in such a manner that waste of petroleum or reservoir energy is avoided*. That will require a determination of whether the operator has performed in a *prudent technical and sound economic manner* which must be founded on an objective evaluation of facts which commonly will require technical expertise, hence not a distinct *legal* determination.

That is comparable to the requirement in the AAPL JOA. Article 5.2.1. specifies that op-

[105] Partly due to differences in civil law and common law tradition. Default law is of more importance in civil law. The reliance on default law partly explains the shorter Norwegian operating agreement compared to the AAPL JOA .

erations must be performed as a *reasonable prudent operator in a good workman-like manner*. To determine whether the operator has acted with such prudence, one must do an objective evaluation of the facts and decide whether the acts were comparable to what a *prudent experienced operator would* do[106]. Hence, not a distinct legal question, but a determination requiring technical expertise.

My area of focus is therefore the operator's duty to safeguard the interest of the non-operators as that is commonly a question of *law*.

3.1.1 Conduct set forth in the agreements

The logical starting point in questions of contractual matters is to examine the contents of the applicable agreements.

3.1.2 The operator's responsibilities under the Norwegian operating agreement

The Norwegian operating agreement does not say much about the duty of the operator to safeguard the non-operators interest. The Norwegian operating agreement article 3.1 (1) only states that the operator shall *carry out and administer the day to day management of the joint venture activities* without giving any more directives to what level of conduct or duty of care to be expected.

3.2 The conduct required in statutory law

Statutory default law is the relevant area of focus in Norway, in the event the agreement itself does not specify the standard of care, and no other evidence is at hand.

[106] *Amoco Production Co. v. Alexander,* 622 S.W.2d 563 (The Supreme Court of Texas – 1981)

For the sake of comparison, that would not be the result in U.S. common law where reliance on statutory default law is less common in contractual relations. One would rather rely on the contracts themselves and previous rulings in cases with same factual basis.

The petroleum act is the foremost act setting forth mandatory rules for petroleum activities and those involved on the N.C.S..
However, neither the petroleum act section 3-7 about *the operator* nor section 1-6(k) about *definitions* sets forth anything related to the duty of care towards non-operators. Neither is anything of guidance specified in the regulations[107].

The remaining statutory provisions are acts setting forth the conduct to expect for the legal enterprises covered by them[108]. However, applying those acts requires a determination of what kind of relationship the operating agreement establishes. If the relationship under the operating agreement falls within any of the categories, the statutory provisions for that category apply.

3.2.1 The character of the venture as determination of the level of care

3.2.1.1 The character of the venture in Norway

The partnership act[109] section 1-1 (4)[110] exempt agreements for joint petroleum activities. Interpreted strictly, the act will seemingly not offer guidance to the any questions that might arise connected to JOAs because they are exempted. However, the preliminary

[107] Regulations to act relating to Petroleum Activities of June 27th 1997
[108] Such as the act relating to general and limited partnerships (the partnerships act) of June 29th 1985 No 83
[109] The act relating to general and limited partnerships (the partnerships act) of June 29th 1985 No 83
[110] § 1-1(4) *Loven gjelder ikke for partrederier etter sjøloven kapittel 5. Den gjelder heller ikke for samarbeidsavtaler knyttet til tillatelse gitt i medhold av Lov 29. november 1996 nr. 72 om petroleumsvirksomhet § 4-3 og samarbeidsavtaler med hjemmel i lovens § 3-3 fjerde ledd og § 4-7, jf. § 4-3, og tilsvarende avtaler inngått før petroleumslovens ikrafttredelse.*

work[111] partly speaks to not apply a strict interpretation of the exemption is section 1-1(4). It reads that *the exemption specified in section 1-1(4) of the partnership act of course will not repudiate the act as default law for queries not explicitly specified in the operating agreement*[112]. (My translation). Thus, the statement in the preliminary work indicates that the partnership act can be applied as *default law* in certain legal enquiries.

Furthermore, the preliminary work[113] states that *by giving the partnership act, objective default law for the* [selskapsforhold] *venture the operating agreement creates be established and can clarify matters not stipulated in the operating agreement. That is generally considered a benefit*[114]. (My translation). The consequence of the statement is that statutory law in the partnership act specifying the duty of care by a person responsible for *carrying out and administering*[115] venture businesses will possibly apply.

One potential source of law is section 2-18(1) in the partnership act regarding *the manager*. The statute reads that the *manager* is the one who ...*carry out the day-to-day administration of the company*[116]. (My translation)
Construing the language objectively, it is a viable contention that the operator is such a *manager*. That would subject the operator of the implied duties of a *manager*, because the operator is the one who carries out the day-to-day administration.
Another factor that speaks to such an analogy is the fact that the operator on the N.C.S. is subject to the supervision and decisions by the management committee, and is responsible for carrying out their decisions. That is quite similar to the *manager* in a partnership who is

---

[111] Ot.prp.nr 47 1984-1985 s.20
[112] Ot.prp.nr 47 1984-1985 s.20: *selvsagt ikke vil vaere til hinder for at loven regler likevel vil kunne tjene som alminnelig bakgrunnsrett for løsning av spørsmaal som ikke er klarlagt i samarbeidsavtalen.*
[113] Ot.prp.nr 47 1984-1985 s.20
[114] *at ved å gi selskapsloven anvendelse, vil deri objektive bakgrunnsretten for det selskapsforhold samarbeidsavtalen etablerer, være klargjort og kunne avklare spørsmål som ikke er løst i samarbeidsavtalen. Generelt må dette sies å være en fordel.* Ot.prp.nr 47 1984-1985 s.20
[115] Article 3.1 (1) in the norwegian operating agreement
[116] Section 2-18(1) in the act relating to general and limited partnerships (the partnerships act) of June 29th 1985 No 83: *forestå den daglige ledelse av selskapet*

supervised by the partners.
The same goes for the fact that the operator can bind the non-operators to third parties, just like a *manager*.
In sum, the operator performs a function quite similar to the *manager* of a company subject to section 2-18 (1) in the partnership act.

On the other hand, such an analogy would entail far-reaching duties of care and a representation which is hard to combine with the fact that the operator is *not* paid, only performing on a no loss-no gain basis.

I find that incorporating the vast duties of care of a *manager* as set forth in the partnership act section 2-18 (1) into the operating agreement would be contrary to the partnership act section 1-1(4) expressly *exempting* operating agreements. The preliminary work[117] shows that the legislature purposely and knowingly exempted the venture under the operating agreement from the partnership act, though they kept the door open for certain analogies. Nevertheless, it cannot have been the intention of the legislature to allow the operating agreement to directly fall within any of the categories of the partnership act. Consequently, the relationship under the operating agreement cannot be deemed anything other than *contractual* relationship where the where the duty of care is determined by laws and principles of contract.
I will come back to that after elaborating the U.S. approach to whether or not the AAPL JOA fits in a category of established enterprises.

3.2.1.2 The character of the venture in the U.S.A.

The lack of an exemption like to one in the Norwegian partnership act section 1-1(4) has caused some litigation in U.S. oil-producing states. Part of the cause for that litigation is

[117] Ot.prp.nr 47 1984-1985 s.20

that *no* law is stating that parties entering into JOAs are *not* forming a legal entity that falls within an established corporate definition[118]. The issue that most often arises is whether or not the JOA creates an ordinary joint venture[119], partnership, agency, trust or similar with established duties and rights.

Non-operators have been especially eager to have the relationship under the JOA deemed a joint venture, partnership, trust or similar because that entails vast responsibilities for the operator not found in mere contractual relationships. One of the main duties in such entities are *fiduciary*-duties which in short obligates the fiduciary to work in the *best interest*[120] of his principal, thus implying a *high standard of conduct*, similar to the duties among partners in a Norwegian partnership[121] or parties to a contractual which requires a very high degree of loyalty, such as a Rt 1967 s.1335.

However, most U.S. courts have found that the JOA is a contractual relationship, *not* a partnership, joint venture, agency, trust or similar. The reasoning behind most of the judgments is that some fundamental conditions for such entities are not met[122]. The condition most prone to litigation is the *mutual control*[123] or *mutual cooperation*[124] criterion, which requires the non-operators to take an active role in the operations for it to be deemed an ordinary joint venture, partnership, trust and similar. It comes without saying that the *mu-*

---

[118] E.g. the Delaware General Corporation Law which governs more than 50% of all publicly traded companies in the US is commonly perceived to express established corporate law. U.S courts tend to apply Delaware law if no other default law applies.

[119] In the U.S.A, Joint Ventures are established legal entities with implied duties and rights. The term does not denote the same as in Norway, where a joint venture is simply a contractual relationship without any specific implied duties

[120] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg. 927

[121] section 1-1(1) in the act relating to general and limited partnerships (the partnerships act) of June 29th 1985 No 83

[122] In re Great Western Drilling, Ltd 211 S.W.3d 828 (Tex. Civ. App. Eastland 2006), Hamilton v. Texas Oil & Gas Corp., 648 S.W.2d 316, 76 O&GR 300 (Tex. Civ. App. El Paso 1982), Berchelmann v. Western Co., 363 S.W.2d 875 (Texas Civil Court of Appeals – El Paso 1962), Edwards v. Hardwick, 350 p.2d 495, 502 (Oklahoma 1960), Blocker Exploration v. Frontier Exploration, Inc., 740 P.d2 983 (the Supreme Court of Colorado 1987), Bovaird Supply Co. v. McClemet, 32 Ill.App.2d 224,234, 177 N.E.2d 430, 434 (Illinois – 1961)

[123] Texas and Mississippi.

[124] Colorado and Oklahoma.

tual control[125] or *mutual cooperation*[126] condition is hard to establish when the operator under the AAPL JOA is declared the venture's *upper body of decision-making* and *carries out the* day to day activities without non-operator interference.
Though, some courts have found the JOA to create an ordinary joint venture, partnership, agency, trust and similar. However, those were cases with some uncommon factual features. Among them that:

1. There were pre-contractual circumstances creating a relationship of trust and confidence[127]

2. The JOA had a special provision that let the non-operators take an active role in the operations[128]

3. The non-operators have taken a more active role in operations than the JOA specifies[129]

4. When the operator was marketing or dealing with kind[130] for non-operator(s)[131]

U.S. courts have thus held that absent such special circumstances, the operating agreement is merely a relationship governed by the contract itself and law of contracts.

For the sake of comparison: that would most likely *not* have been the case if the operator in the U.S.A. could contract on *behalf*[132] of the non-operators, as he can in

[125] Texas and Mississippi.
[126] Colorado and Oklahoma.
[127] Schmude Oil Co. v. Omar Operating Co., 458 N.W.2d 659 (Michigan Civil Court of Appeals – 1990)
[128] Blocker Exploration v. Frontier Exploration, Inc., 740 P.d2 983 (the Supreme Court of Colorado 1987)
[129] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg. 805
[130] U.S. connotation for oil, gas or both.
[131] Holloway v. Atlantic Richfield Co., 970 S.W.2d 641 (Tex. Civ. App. Tyler 1998)
[132] Article 9.2 the Norwegian operating agreement

Norway. Under U.S. Law of Agency, he would be deemed an *agent* of the non-operators falling into a category with associated fiduciary duties which entail among other things that the exculpatory clause is unenforceable.

The conclusion is that the characterization of the relationship established by the operating agreement is the same in both the U.S. and Norway. The duty of care will be determined by law of contracts in both jurisdictions.

3.3 The duty of care derived from law of contracts

I will start with the lowest duty of care which is the duty to act in *good faith* throughout the duration of the contract, before examining and comparing the duty of care derived from the doctrine of *loyalty in contracts* which is the principal source of law for the question at hand.

3.3.1 The duty of *good faith* in Norway

The code on contract § 33 sets forth that parties engaging in contractual obligations has a general duty to act in *good faith* that applies pre-contractually, at time of closing and for the duration of the contract[133]. Pre-contractual obligations and duties of care at closing is largely irrelevant because entering into the operating agreement is term for obtaining the production license. The duty of good faith will consequently be of significance *after* the parties have entered into the operating agreement.

The duty to act in good faith set forth in section 33 implies a rather low standard of conduct which in short terms requires the receiving party to disclose any knowledge of circumstances that speaks to *not* let the agreement or subsequent promises be binding. An example of such a situation is the case when the *recipient* knows of circumstances crucial for the

[133] Rt. 2002 s.1155

performance of the contract, that the *presenter* of the obligation doesn't know, and, the *recipient* knows that the *presenter* isn't able to act in its own best interest because of the missing information. Applied to the operator in a JOA, he would be forced to disclose knowledge of any circumstance that he knows is crucial for the performance of the ventures activities to the management committee. Typically, an operator would have a duty to disclose that a contractor has proved incapable of performing satisfactory according to common standards of the oil and gas industry when informing the management committee. I will next determine whether the same duty of *good faith* apply to the operator under the AAPL JOA.

3.3.2 The duty of *good faith* under the AAPL operating agreement

In *M&T, Inc.v. Fuel Resources Development Co.*[134], the court found that the operator was obligated to use *due care* and show *good faith* when estimating costs in the AFE[135]. Acknowledged legal scholars interpret the judgment so that that the good faith requirement applies in other operations as well[136]. Thus, there is support for suggesting that a good faith obligation exists under the AAPL JOA.

Another case regarding the preparation of an AFE[137] can be explanatory for the substance of the *good faith* obligation.

In *Varn v. Maloney*[138] the court found the operator in breach of the duty of good faith and due care when *negligently preparing an instrument which he knows the other participants will rely on in making the decision to authorize drilling.*

From the statement, the court lets the duty of good faith apply to the *receiver* of the contractual obligation and provides a remedy for neglecting to properly inform co-contractors of matters of importance to them [In the case, signing the AFE]. The court requires the pre-

---

[134] *M&T, Inc. V. Fuel Resources Development Co.*518 F. Supp.285 70 O&GR 232 (D. Colo. 1981)
[135] Authorization for Expenditure
[136] Ernest E. Smith, *Duties and Obligations Owed by An Operator to Non-operators, Investors and Other Interest Owners,* 1986 Rocky Mountain Mineral Law Foundation, pg.9
[137] Authorization for Expenditure
[138] *Varn v. Maloney* 516 P.2d 1328, 47 O&GR 521 (Okla.1973)

senter of the promise to *disclose* information he know is of importance to the receiver which comparable to the requirements under the *good faith* obligation in Norway. Another parallel is the *degree of fault* of fault necessary for the party in breach. In *Varn v. Maloney*[139] and *Argos Resources, Inc. v. May Petroleum, Inc.*[140] the court finds breach of the duty of good faith, even though the party in breach was merely acting *negligently.* It is written in the preparatory work[141] to section 33 in the code of contracts that *one must emphasize whether a party showed negligence.* Thus, in both jurisdictions, the *good faith* obligation does not require the party in breach to act willfully. Ordinary *Negligence* is sufficient to be in breach.

Conclusively, there is a good faith requirement under both the AAPL JOA and the norwegian operating agreement with equal substance, equal structure and equal application.

The question that naturally arises is whether or not a *higher* duty of care can be derived from the *doctrine of loyalty in contracts*[142].

3.4 The duty of care derived from the doctrine of loyalty in contracts

The doctrine of *loyalty in contracts* is a non-statutory dynamic legal standard derived from the duty of good faith set forth in section 33 in the code on contracts[143]. It is perceived to be an *implied covenant* in contractual relationships and has effect in the pre-contractual, at time of closing and for the duration of the contract[144] . The covenant is perceived to be set forth a wider array of duties than the duty of good faith. The general content of covenant is

---

[139] *Varn v. Maloney 516* P.2d 1328, 47 O&GR 521 (Okla.1973)
[140] *Argos Resources, Inc. v. May Petroleum, Inc.* 693 S.W. 2d.663, 86 O&GR 594 (Texas Civil Court of Appeals – 1985)
[141] Ot. prp. nr. 63 1917 s. 86 «Man tænke særlig paa spørsmaalet om uagtsomhet er vist»
[142] Prinsippet om lojalitet i kontraktsforhold
[143] Rt.1953 s.581
[144] Rt. 1995 s.1460 *Haughom*

a mutual obligation to diligently protect the interest of the co-contractor(s) *showing due care and loyalty at all stages of the contractual relationship*[145]. Some of the obligations that have been articulated by courts based the doctrine are:

(1) An obligation to work for the realization of the *common objective* of the contract[146],[147]

(2) A duty to keep the co-contractor(s) *informed* about matters that may affect the objective of the contract, typically when unexpected circumstances or new conditions alternates the basis for the contractual obligation[148]. Typically circumstances that the other party has a reasonable expectation to be informed about.

(3) A duty to diligently *limit losses* if breach of contract/default[149]

The extent of these obligations varies under the doctrine depending on factors such as the *type*[150] of contract and *length*[151] of contract.
When considering the amount of type of contract, herein the capital involved, and the average length of a JOA[152], it is quite apparent that the doctrine applies to its full extent.

The first question that arises is whether or not a similar doctrine applies to the AAPL JOA for operations in the U.S.A.

A partially comparable principle to the doctrine of *loyalty in contracts* is the contractual

---

[145] Rt. 1988 s.1078 S*kipsgaranti*
[146] Rt. 1967 s.1335 *Sildoljefabrikker*
[147] Rt.2004 s. 1256
[148] Rt. Rt.1936 s. 909 *Ordbok dommen*
[149] This obligation arises out of the duty to work for the common objective of the contract.
[150] Rt.1936 s. 909 *Ordbok dommen*
[151] Rt.1936 s. 909 *Ordbok dommen*
[152] Typically 20-30 years. Source: Information from Professor (J.D) Owen L. Anderson, *Eugene Kuntz Chair of Law in Oil, Gas and Natural Resources*, the University of Oklahoma College of Law.

principle of cooperation[153]. The *principle of cooperation* requires operator and non-operators to *cooperate to carry out the objective* of the contract[154], which is comparable to the obligation to *work for the realization of the common object of the contract*[155] derived from the doctrine of *loyalty in contracts.*

The principle has been applied in a case brought in for the United States Supreme Court regarding an oil and gas lease. In *Sauder v. Mid-Continent Petroleum Corporation*[156], the Supreme Court of the United States said that *a covenant on respondent's part to continue the work of exploration, development and production is to be implied from the relation of the parties and the object of the lease.*

Thus, the U.S. Supreme Court stressed *the relationship* and *the object*[157] of the instrument in question, comparable to the Norwegian Supreme Court emphasizing the *object* of the contract in Rt. 1967 s.1335.

The question that remains is whether there is a source of law that specifies an even *higher* standard of conduct under the AAPL agreement.

I have not found any applicable sources setting forth a higher standard than the doctrine of *loyalty in contracts.*

For the AAPL JOA, the answer to the question is presumably *yes*. Article 5.2.1 of the agreement sets forth a standard of conduct that not only obligates the operator to act in *good faith*[158] and work toward the *realization of the common objective*[159], but imposes *additional* duties upon the operator.

---

[153] Professor Howard Williams and Charles Myers, *Oil and Gas Law,* §802.1
[154] Professor Howard Williams and Charles Myers, *Oil and Gas Law,* §802.1
[155] Rt. 1967 s.1335 *Sildoljefabrikker*
[156] *Sauder v. Mid-Continent Petroleum Corporation*, 292 U.S. 272 (the Supreme Court of the United States - 1934)
[157] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg. 450
[158] *Varn v. Maloney 516* P.2d 1328, 47 O&GR 521 (Oklahoma - 1973),
[159] *Argos Resources, Inc. v. May Petroleum, Inc.* 693 S.W. 2d.663, 86 O&GR 594 (Texas Civil Court of Appeals – 1985)

Therefore, I will first scrutinize article 5.2.1 of the AAPL JOA, before I compare it to doctrine of *loyalty in contracts* and analyze the findings.

3.5 The conduct specified in article 5.2.1 of the AAPL JOA

The AAPL JOA article 5.2.1 specifies that *The Operator shall timely commence and conduct all activities or operations in a good and workmanlike manner, as would a prudent operator under the same or similar circumstances.* The language has been interpreted to set forth an obligation to act as *a reasonable prudent operator*[160], which is the same standard of conduct that has been applied between lessees and lessors as an implied covenant[161] to property leases. A question that I will make an attempt to answer is whether the doctrine of *loyalty in contracts* imposes the same duties as the *reasonable prudent operator standard.* However, I find it necessary to elaborate the content of the standard first.

The *reasonable prudent operator standard* is not defined anywhere in the JOA. For that reason, interpretations by courts and acknowledged legal scholars are by and large the only sources of guidance on how to construe it.

The *reasonable prudent operator standard* can be separated in two:

(a) It specifies how the operator shall produce from the well. Typically, avoid drainage and other *waste*[162]. Avoiding *Waste* means that the operator is obligated to negate excessive loss of reservoir energy and other economic waste by means of offset wells, enhanced recovery methods and so forth.
Thus, that part of the obligation is comparable to section 4-1 of the petroleum act obliging

[160] Ernest E. Smith, *Duties and Obligations Owed by An Operator to Non-operators, Investors and Other Interest Owners,* 1986 Rocky Mountain Mineral Law Foundation, pg.9
[161] Gary Conine, *The Prudent Operator Standard: Applications beyond the Oil and Gas lease,* 41 Natural Resources Journal (2001) pg.67
[162] *Amoco Production Co. v. Alexander,* 622 S.W.2d 563 (The Supreme Court of Texas – 1981)

the operator to apply *prudent technical and sound economic principles in such a manner that waste of petroleum or reservoir energy is avoided.*

(b) It specifies to what degree the operator shall make sure that the non-operators' interest are observed.

The mentioned obligations in (a) and (b) are interrelated. If the operator is not performing well operations prudently, the consequence is harm to the non-operators interest. Courts tend to mingle the duties by handing down broadly termed opinions that comprise every operation carried out by the operator. I will as already mentioned, focus on how the operator must care for the interests (b) of the non-operators.

The Supreme Court of Kansas elaborated the defined the *reasonable prudent operator standard* in *Smith v. Amoco Production Co.,*[163] where the court evaluated Amoco's (Operator and lessee) marketing decisions in light of the changing environmental regulatory environment to determine whether Amoco had acted as a *reasonable prudent operator*. In remanding the case to the district court, the following guidelines where provided to evaluate whether Amoco had exercised its judgment as a reasonable prudent operator in a good workman-like manner: (1) The operator's conduct will be evaluated by considering "*What an experienced operator of ordinary prudence would do under the same or similar circumstances, having due regard of the interest of both…[Lessor and lessee]"* (2) *Evaluation of the prudent operator standard is a question of fact.*

It can be read from the opinion provided by the Kansas Supreme Court that the first part establishes and *objective* standard of conduct dependent on what an experienced operator with ordinary prudence would do.
It is quite clear that this standard of conduct does not give obligations that come close to

[163] *Smith v. Amoco Production Co.,* 31P.3d.255 (The Supreme Court of Kansas – 2001)

those of a *fiduciary*. A *fiduciary* is, in short, obligated to work in the *best interest*[164] of his principal, not only have *due regard of the interest* of his principal. Thus, a deriving a lower standard is the correct approach.

Acknowledged legal scholars claim that *due regard* for the interest of both parties mean that the operator is:

> (1) Subject to a duty of keeping non-operators informed of matters that the operator, when exercising his best judgment, considers important[165].
>
> (2) *Free to act on an arm's length basis in accordance with their own respective self-interest*[166]. Acting on *an arm's length basis* means that the parties act independently in contracts and have prior no relationship to each other that can alter the terms of the transaction[167].

A case from the Supreme Court of Norway, Rt. 1967 s.1335 *Sildolje*, regarding duty of care and loyalty owed by producers of Herring-oil speaks can serve a basis for comparison of the duties.

Besides producing oil, the contractual relationship between the producers was quite similar to that of an operating agreement.

The facts of the case were the following: Herring-oil producers united to share quotas in a profit-maximizing way. The producers jointly established an office with the sole purpose of working to the benefit of the producers and dividing quotas equally. However, some of the producers got bigger quotas without the office's blessing, thus achieving an advantage not

---

[164] John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law,* Fifth Edition, Thompson West pg. 927

[165] Ernest E. Smith – University of Texas School of Law, *Duties owed by an operator to a non-operator under voluntary agreements and compulsory orders,* 1997 Rocky Mountain Mineral Law Foundation, pg.4.

[166] Ernest E. Smith, John S. Lowe*, The Operator: Liability to Non-operators, Resignation, Removal and Selection of a Successor*, 2008 Rocky Mountain Mineral Law Foundation pg.3

[167] Information from Professor (J.D) Owen L. Anderson, *Eugene Kuntz Chair of Law in Oil*, *Gas and Natural Resources*, the University of Oklahoma College of Law

shared with the others. The other producers brought action claiming that the producers with the bigger quotas were in breach of their contract by not working for the common objective of the contract.
The contract didn't say anything about acquiring quotas "on the side".

The Supreme Court found the producers who gained bigger quotas were in breach of their contract.
The court held that one must assume that agreements for cooperative purposes are observed loyally. It further stated that there is no need for a clause saying that parties cannot engage in parallel businesses in the same industry, because such activity would counteract the *common objective* of the contract. Further, the court held that the doctrine of *loyalty in contracts* has two fundamental implications: (1) The parties must refrain from certain acts, and (2) The parties must *act* to ensure that the duty of loyalty is observed.

It can seem like the Supreme Court impose a *high level of conduct* on parties to contracts for cooperative purposeswhen it is stating that it's an implied covenant to such agreements that the parties cannot engage in competing businesses.
It can be derived from the reasoning of the court that the level of conduct under the doctrine of *loyalty in contracts* will be determined based on the collaborative nature of the relationship in the contract.
Applied to the operating agreement supports a finding that the operating agreement requires a somewhat high level of care.

However, applying the holding from *sildolje* to operating agreements in the oil and gas industry has some implications:

For one thing, nobody would enter into a *cooperative* operating agreement like the JOA if that negated competitive activity on other tracts. Companies in the oil and gas industry ordinarily spread their capital and interest over several ventures, not like most of the herring-oil producers who had their capital vested in only one at the time *sildolje* was litigated

The second issues that speaks to not let the holding have any effect on JOAs is that it is doubtful whether the factual basis of the agreement in *siljolje* and the operating agreement is close enough. The operating agreement in *sildolje* was intended to create a *monopoly*-like environment for producers of Herring-oil. An agreement to create a *monopoly* is not worth much if any of the parties engage in competing businesses at different terms. Thus, resisting from competitive transaction must be deemed the foremost duty in such an agreement. It would alter the entire basis for the cooperation.

On the other hand, disregarding the monopoly-like aspect of the agreement in *Sild-olje,* the agreement is entered into to create a *cooperative* environment for the common goal, create best possible terms for the parties to it. That is closely related to the operating agreement to which parties enter to produce as much oil and gas possible for the lowest possible cost. Thus, the agreement's two main purposes are
(1) Generating as much profit possible for the parties
(2) Creating a cooperative environment for the benefit of the parties

These are purposes that the operating agreement and the cooperative agreement in sild-olje have in common.

When observing that the Supreme Court of Norway allows a *variable* duty[168] of care and loyalty in contracts based on criteria such as the *length*[169] and *type* [170]of contract, it is quite evident that the operating agreement with its *cooperative features* is a *type* of agreement that requires a high level of care and loyalty. An example underpinning that is the reality that non-operators are letting one of their *competitors* act on their *behalf* and carry out the day-to-day operations for them.

---

[168] Rt. Rt.1936 s. 909 *Ordbok dommen*
[169] Rt. Rt.1936 s. 909 *Ordbok dommen*
[170] Rt. Rt.1936 s. 909 *Ordbok dommen*

The *variable* duty also allows one to disregard the fact that the parties' intention in *sildolje* was to create a monopoly-like environment, and consequently, disregard the courts finding that relates to the monopoly aspect of the agreement. The consequence of *not* disregarding these factors would be a finding that parties to cooperative agreements were not allowed to engage arm's length transactions.

My conclusion is that duties of care set forth in *sildolje* will partly apply to the Norwegian operating agreement because of the cooperative element which requires a particularly high level of care. In sum, that would oblige the operator to have *due care* for the non-operators, but still have the ability to engage in arm's length transactions.
The standard of care would consequently correspond to the duty of care of the *reasonable prudent operator standard.*

Whether or not a variable duty of conduct applies under the AAPL JOA has been subject to litigation in the U.S.A.

3.5.1 The reasonable prudent operator standard – A variable standard

Legal scholars claim that one aspect of the *reasonable prudent operator standard* is that it is *not* a constant standard of conduct, but depending upon the type of activity involved[171]. The following case is an example of that. In *Holloway v. Atlantic Richfield*[172] the question was, among other issues, whether defendant, the operator, Atlantic Richfield (Later Arco) owed a higher (fiduciary) duty when marketing plaintiff's, Halloway's, natural gas. The Texas court of appeals found that such a duty existed when the operator was handling money for the non-operator.
The court reasoned that …*a duty did arise when Arco marketed Holloway's gas. But it was*

[171] Ernest E. Smith, John S. Lowe, The Operator: Liability to Non-operators, Resignation, Removal and Selection of a Successor, 2008 Rocky Mountain Mineral Law Foundation pg.5
[172] Holloway v. Atlantic Richfield Co., 970 S.W.2d 641 (Tex. Civ. App. Tyler 1998)

a limited duty to account for the monies received for selling his gas, to avoid conflicts of interests, and not to act as an adverse party in its capacity as the seller of his gas…
It is quite clear that the court imposes a different duty upon the operator when handling money on behalf of another party to the JOA. The court apparently acknowledges that a variable duty of conduct can occur between parties to a JOA, depending on the *type* of operations undertaken. That partly correlates to the courts conclusions in Rt. 1936 s. 909 which implies that the extent of obligations under the doctrine of loyalty in contracts *varies* depending on factors such as the *type* of contract[173] and *length* of contract[174].
The Texas court seemingly imposes duties of an *agent* upon the operator and provides Halloway with rights as it was the *principal,* when the operator is handling of money on Halloway's behalf. Whether or not the court emphasizes what parties that are *benefiting* from the operation when determining if a higher level of conduct applies, is not clear. Reasoning from the courts explanation, especially the part saying that Halloway (operator) had a higher level of conduct that was a *limited duty to account for the monies received for selling his (*Atlantic Richfield*) gas* the court seems to accentuate that Atlantic Richfield was the only one having an interest in the *monies* for only one person. It is therefore a viable contention that a variable duty arise under the *reasonable prudent operator standard,* just as under the doctrine of loyalty.

For that reason, one may ask whether or not a Norwegian court applying the doctrine of *loyalty in contracts* would have found that an operator who is marketing gas on behalf of a non-operator is bound to a *higher* or *lower* duty of care than he is bound to under the JOA. For one thing, the JOAs govern *upstream* oil and gas production, not downstream gas marketing. (Unless the operating agreement has provisions for gas-balancing). A court could reason that the gas marketing obligation was another *type*[175] of contract, not an operating agreement, thus requiring a different level of care. Furthermore, a court could reason that the marketing agreement requires a *higher* standard of conduct because only the under-

[173] Rt.1936 s. 909 *Ordbok dommen*
[174] Rt.1936 s. 909 *Ordbok dommen*
[175] Rt.1936 s. 909 *Ordbok dommen*

produced non-operator would benefit from the marketing, by that creating a relationship of trust and confidence[176].

The answer is not apparent, but the variable duty under the doctrine of *loyalty in contracts* allows a flexibility like the U.S. courts seems to employ to the operating agreements.

3.6 Conclusion:

Both the *reasonable prudent operator standard* and the doctrine of *loyalty in contracts* impose a variable standard of care dependent upon the type of operations undertaken and *type* of agreement.

They both impose an obligation to work for the realization of the *common objective* of the contract[177],[178], keep non-operators *informed* about matters that may affect the objective of the contract, and both gives an opportunity to engage in arm's length transactions for own benefit.

However, a distinction is that the duty of care under the *reasonable prudent operator standard* has a more established content. An example is the definite duty to have *due regard* of the non-operators interest which is derived from the *reasonable prudent operator standard*. It is established that the operator is *free to act on an arm's length basis in accordance with his own respective self-interest* while having *due regard* for the non-operators. The doctrine of *loyalty in contracts* does not support that level of predictability for the operator.

The level of conduct required of the operator under the doctrine of *loyalty in contracts* will be determined based on factors such as the collaborative nature of the relationship under the operating agreement, and reasonable expectations of the parties.

---

[176] Rt. 1951 s.371
[177] Rt. 1967 s.1335 *Sildoljefabrikker*
[178] Rt.2004 s. 1256

4 List of references

Acts, regulations and preliminary work

Norway

Ot.prp.nr. 63 1917 s. 86

Ot.prp.nr 47 1984-1985 s.20

The Act relating to petroleum activities of November 29th 1996 No. 72

The Regulations Act relating to Petroleum Activities of June 27th 1996 No. 653

The Act relating to the taxation of subsea petroleum deposits of June 13th 1975 No. 35

The Act concerning unlimited liability partnerships and limited partnerships of June 29th 1985 No. 83

The Act relating to procedure in cases concerning the public administration of February 10th 1967

Lov av 27.11.1992 nr. 109 om gjennomføring i norsk rett av hoveddelen i avtale om Det europeiske økonomiske samarbeidsområde (EØS) m.v. (EØS-loven)

Lov av 19.juni 2009 nr.101 om erverv og utvinning av mineralressurser

Lov av 5.april 1973 nr.21 om undersøkelser etter og utvinning av petroleum i grunnen under norsk landområde

U.S. Federal Law

The submerged Lands Act of 1953 43 U.S.C.

The Outer Continental Shelf Lands Act of 1953 43 U.S.C

International Law

The United Nations Convention on the Law of the Seas 1982

Literature

Norwegian Literature

Kristian Huser, *Avtaletolkning,* 1983

Anne-Karin Nesdam, Knut Kaasen, Jan B Jansen og Joachim M Bjerke, *Articles in Petroleum Law*, MarIus 404

kandidatnr. 166158, *Samarbeidsavtalens ansvarsbegrensningsklausul for operatører på norsk sokkel – en fremstilling*, veileder Johs. Faugstad

Knut Kaasen, *Statdeltakelsesavtalen i norsk petroleumsvirksomhet*: *Kontraktsrettslig form, konsesjonsrettslig innhold- eller omvendt?* Tidsskrift for rettsvitenskap 1984

Hammer, Ulf m.fl., *Petroleumsloven*, Oslo 2009

Tine Harstad Eggen,"*No gain-No loss"-prinsippet I petroleumsvirksomhetens samarbeidsavtaler*, MarIus 359

U.S. Literature

Howard Williams and Charles Myers, *Oil and Gas Law*, Thompson West 2010

Ernest E. Smith, John S. Lowe, The Operator: *Liability to Non-operators, Resignation, Removal and Selection of a Successor,* 2008 Rocky Mountain Mineral Law Foundation

John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, *Cases and Materials in Oil and Gas law*, Fifth Edition, Thompson West

Hendricks, K., R. Porter, and G. Tan, *Bidding Ring and Winner's Curse: The Case of Federal Offshore Oil and Gas Lease Auctions*, NBER working paper 9836

Ernest E. Smith, *Duties and Obligations Owed by An Operator to Non-operators, Investors and Other Interest Owners*, 1986 Rocky Mountain Mineral Law Foundation,

Gary Conine, *The Prudent Operator Standard: Applications beyond the Oil and Gas*

lease, 41 Natural Resources Journal (2001)

Ernest E. Smith – University of Texas School of Law, *Duties owed by an operator to a non-operator under voluntary agreements and compulsory orders,* 1997 Rocky Mountain Mineral Law Foundation

Correspondence

Professor (J.D) Owen L. Anderson, *Eugene Kuntz Chair of Law in Oil, Gas and Natural Resources,* the University of Oklahoma College of Law

Websites

NOAA, Office of Coast Survey, www.nauticalcharts.noaa.gov/csdl/mbound.htm
http://www.nola.com/business/index.ssf/2013/03/oil_leases_up_for_bid_in_centr.html
BOEM http://www.boem.gov/Oil-and-Gas-Energy-Program/Leasing/Regional-Leasing/Gulf-of-Mexico-Region/Gulf-of-Mexico-Top-Ten-Highest-Number-of-Bids-on-a-Single-Block-for-All-Sales.aspx
U.S. Government Accountability Office: http://www.gao.gov/new.items/d07676r.pdf

Court decisions

From Norway

Rt. 2002 s.1155
Rt. 1967 s.1335 *Sildoljefabrikker*
Rt.2004 s.1256
Rt.1936 s.909 *Ordbok dommen*
Rt. 1951 s.371

From the U.S.A.

Sauder v. Mid-Continent Petroleum Corporation, 292 U.S. 272 (the Supreme Court of the United States - 1934)
Cherokee Nation v. Georgia, 30 U.S. (5 Pet.) 1, 17 (1831)
Amoco Production Co. v. Alexander, 622 S.W.2d 563 (The Supreme Court of Texas – 1981)
In re Great Western Drilling, Ltd 211 S.W.3d 828 (Texas Civil Court of Appeals - Eastland

2006)
Hamilton v. Texas Oil & Gas Corp., 648 S.W.2d 316, 76 O&GR 300 (Texas Civil Court of Appeals - El Paso 1982)
Berchelmann v. Western Co., 363 S.W.2d 875 (Texas Civil Court of Appeals – El Paso 1962)
Edwards v. Hardwick, 350 P.2d 495, 502 (Oklahoma - 1960)
Blocker Exploration v. Frontier Exploration, Inc., 740 P.d2 983 (the Supreme Court of Colorado 1987)
Bovaird Supply Co. v. McClemet, 32 Ill.App.2d 224,234, 177 N.E.2d 430, 434 (Illinois – 1961)
Schmude Oil Co. v. Omar Operating Co., 458 N.W.2d 659 (Michigan Civil Court of Appeals – 1990)
Blocker Exploration v. Frontier Exploration, Inc., 740 P.d2 983 (the Supreme Court of Colorado 1987)
Holloway v. Atlantic Richfield Co., 970 S.W.2d 641 (Texas Civil Court of Appeals - Tyler 1998)
Varn v. Maloney 516 P.2d 1328, 47 O&GR 521 (Oklahoma - 1973)
*M&T, Inc. V. Fuel Resources Development Co.*518 F. Supp.285 70 O&GR 232 (D. Colorado - 1981)
Argos Resources, Inc. v. May Petroleum, Inc. 693 S.W. 2d.663, 86 O&GR 594 (Texas Civil Court of Appeals – 1985)

Attachments

1. Avtale for petroleumsvirksomhet

2. Den norske samarbeidsavtalen for 22. Lisens-runde

3. American Association of Professional Landmen's 810 offshore model-form Joint Operating Agreement for the Gulf of Mexico.